

Editor's note: Appealed -- aff'd, Civ.No. 84-0916 "L" (W.D. La. Feb. 5, 1986), 627 F.Supp. 1375; vacated for lack of jurisdiction; remanded to W.D. La. for transfer to Ct. Cl. No. 86-4168 (5th Cir. April 29, 1987), 815 F.2d 352; cert denied, 487 US 1234 (1988); aff'd, No. 344-87L (Cl. Ct. Aug. 7, 1989), 17 Cl. Ct. 590

AMOCO PRODUCTION CO.

IBLA 83-681

Decided December 19, 1983

An appeal of a decision by the Director, Minerals Management Service, denying a protest against a determination that royalty for certain gas produced from oil and gas lease OCS-G 2866 was underpaid, and a later assessment of a late payment charge.

Affirmed.

1. Oil and Gas Leases: Royalties -- Outer Continental Shelf Lands Act:
Oil and Gas Leases

The United States, as lessor of an oil and gas lease, is entitled to its royalty based on "the reasonable value" of the gas as set by the Secretary. Where a party challenges a determination as to the value of gas produced, the party must establish that the methodology used in the Government's computation is, in fact, erroneous.

2. Laches -- Outer Continental Shelf Lands Act: Oil and Gas Leases --
Payments: Generally

30 CFR 250.49 authorizes Minerals Management Service to impose a late payment interest charge where royalty payments for offshore oil and gas leases are untimely or improper. The authority of the United States to enforce a public right or to protect a public interest is not vitiated or lost by acquiescence of its officers or by their laches, neglect of duty, failure to act, or delays in the performance of their duties.

APPEARANCES: William M. Meyers, Esq., George J. Domas, Esq., Deborah Bahn Price, Esq., New Orleans, Louisiana, for Amoco Production Company; Charles R. Shockey, Esq., Department of the Interior, Office of the Solicitor, Washington, D.C., for Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE STUEBING

Amoco Production Company (Amoco) appeals the April 4, 1983, decision of the Director, Minerals Management Service (MMS), denying its protest against a July 20, 1982, determination that it underpaid its royalty obligation by \$10,424,298.62 for gas produced from oil and gas lease OCS-G 2866 between February 1977 through December 1979 and sold to Florida Power and Light (FP&L), and a September 17, 1982, determination that Amoco was liable for late payment assessments in the amount of \$3,920,015.52.

Lease OCS-G 2866 was issued effective December 1, 1974, under the authority of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. §§ 1301-1343 (1970), for all of Block 23, Vermilion area, Offshore Louisiana (map No. 3), constituting approximately 5,000 acres. The lease required the lessee to "pay the lessor a royalty of 16-2/3 percent in amount or value of production saved, removed, or sold from the leased area." Since commencement of production under the lease, Amoco has sold its share of the natural gas produced to Florida Gas Transmission (FGT) and FP&L under a contract executed in 1965. 1/ On February 1, 1977, Geological Survey (Survey), predecessor to MMS in functions concerning offshore mineral lease management, advised Amoco that royalty value for gas sold to FP&L was to be based on "well spud dates pursuant to Federal Power Commission [(FPC)] Opinion No. 770-A." 2/ Effective December 1, 1978, Opinion No. 770-A prices were incorporated in section 104 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3314 (Supp. V 1982). 3/

After a review of Amoco's royalty computations submitted for the period February 1974 through December 1979, MMS issued a determination dated July 20 1982, stating as follows:

Our review shows that for the period of February 1977 through February 1979, Amoco valued its share of natural gas from the referenced lease at the Florida Gas Transmission (FGT) contract price of \$.2125 per MCF. However, Amoco was shipping a portion of its share of the natural gas to Florida Power and Light Company (FP&L). For the period of March 1979 through December 1979, Amoco included only a portion of the natural gas shipped to FP&L at NGPA, Section 104, Post 1974 prices in their computation of MMS royalties. Amoco's computation of MMS royalties for shipments made to FP&L are not in accordance with the MMS value determination letter to Amoco, dated February 1, 1977 (see attached). This letter established the fair market value to be a rate that would be received based upon well spud dates pursuant to FPC Opinion No. 770-A. (Title 30 CFR 250.64).

1/ Amoco is a 33.33333 percent shareholder in OSC-G 2866. The contract with FP&L was cancelled by its terms in Jan. 1967, but was reinstated, as modified, on Aug. 4, 1967.

2/ The value for gas sold to FP&L was to be calculated pursuant to FPC Opinion No. 770-A as follows: (15.025/14.73) [Base Price (BTU determination/1000) + gathering allowance + transportation allowance].

3/ The maximum lawful price under this section for any month was to be the higher of:

"(A)(i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and (ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before November 9, 1978, and which is applicable to such natural gas."

During September through December 1979, Amoco computed MMS royalties based upon calculated volumes, which deleted gas volumes bypassed around the gas processing plant. Additionally, when Amoco computed MMS royalties based upon residue and natural gas liquid products, residue gas used as dehydration station fuel was not included in the royalty computation. Gas used as fuel for gas treatment functions should be included in the computation of royalties due MMS.

MMS concluded that the royalty payments for the period in question were deficient by \$10,424,298.62, 4/ and informed Amoco that late payment changes would be assessed pursuant to 30 CFR 250.49.

Amoco appealed to the Director, MMS, arguing that production value should be based on the proceeds received under the contract for sale to FP&L and that MMS failed to adequately consider the regulatory effect of NGPA in making its decision. Meanwhile, MMS issued a late payment assessment of \$3,920,015.52, which Amoco protested as premature and inequitable. 5/

The Director, MMS, affirmed the July 20, 1982, determination in an April 4, 1983, decision because the FP&L contract "merely was a warranty contract," and thus Amoco was "free to sell the gas in question to a third party at the FPC Opinion No. 770-A vintage III prices and later at the NGPA Section 104 post-1974 prices." Moreover, the Director declared that Amoco was precluded from challenging the production values established by the February 1, 1977, value determination letter because it had failed to timely appeal that action.

Amoco has, in turn, appealed to this Board pursuant to 30 CFR 290.7, asserting that the Director's decision was erroneous in the following conclusions: (1) All relevant factors listed in 30 CFR 250.64 regarding royalty valuation were considered and adequately explained; (2) the FP&L contract price was not the maximum price under NGPA; and (3) Amoco could sell gas from OCS-G 2866 to third parties and still satisfy its contractual warranty obligations to FP&L with gas from other sources. In regard to the late payment charges, Amoco argues that assessment of such charges is premature, as no final adjudication has been made that Amoco is liable, and that it is inequitable for MMS to assess a charge for the late payment.

[1] The Secretary of the Interior is authorized to lease tracts of the Outer Continental Shelf under OCSLA for the exploration and development of mineral resources, including oil and gas. In passing the Act, Congress committed the Government to the goal of obtaining fair market value for Outer

4/ With regard to the gas shipped to FP&L during the period Feb. 1977 through Nov. 1978, the additional royalties demanded were based on the rate approved by FPC Opinion No. 770-A with respect to Vintage III gas.

As to gas shipments to FP&L during the period Dec. 1978 through Dec. 1979, royalties were recomputed with reference to well spud dates on the basis of the NGPA section 104 post-1974 prices.

5/ The amount assessed was determined after Amoco's payment of deficient royalty was received on Aug. 20, 1982.

Continental Shelf (offshore) oil and gas resources. Watt v. Energy Action Educational Foundation, 454 U.S. 151, 162 (1981). 6/ Computing the royalties payable for offshore gas production involves: (1) A determination of the amount of production on which royalties are to be paid; (2) a determination of the value of the gas produced; (3) a determination of the deductions to be allowed; and (4) application of the rate of royalty provided for in the lease.

The Secretary of the Interior possesses considerable discretion for determining what is the "value" of production. 7/ Indeed, the lease signed by Amoco states that the lessee "expressly agreed that the Secretary may establish minimum values for purposes of computing royalty on production obtained." The exercise of the Secretary's statutory discretion is found in the promulgation of 30 CFR 250.64, which establishes the factors to be considered when determining value for royalty computations.

The version of 30 CFR 250.64 in effect in 1977 when the value for gas sold to FP&L was determined, read as follows:

The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to

6/ 43 U.S.C. § 1344(a)(4) (Supp. V 1981) states: "Leasing activities shall be conducted to assure receipt of fair market value for lands leased and the rights conveyed by the Federal Government." See also 43 U.S.C. § 1344(a)(1) (Supp. V 1981).

7/ In 1977, section 8(b) of OCSLA, 43 U.S.C. § 1377(b) (1976), read: "An oil and gas lease issued by the Secretary pursuant to this section shall * * * require the payment of royalty not less than 12-1/2 per centum in the amount or value of the production saved, removed, or sold from the lease * * *."

Nowhere does the Act provide a process or scheme for determining "value," should royalty be exacted in other than "kind." However, section 5(a)(1) of OCSLA, 43 U.S.C. § 1334(a)(1) (1976) stated in part: "The Secretary shall administer the provisions of this subchapter relating to the leasing of the Outer Continental Shelf, and shall prescribe such rules and regulations as may be necessary to carry out such provisions." See also 43 U.S.C. § 1334(a) (Supp. V 1981) (1978 amendment to OCSLA).

By comparison, section 32 of the Mineral Leasing Act of 1920, 30 U.S.C. § 189 (1976), provides: "The Secretary of the Interior is authorized to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes of this chapter [relating to onshore mineral leasing]." In view of that language, we held that "the Secretary of the Interior has considerable latitude in determining what is the 'value' of production from a lease on which royalty payments are made." Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981), rev'd on other grounds, Hoover & Bracken Energies, Inc. v. Dept. of Interior, No. CIV-81-461T (D.C. Okla. Nov. 18, 1981), appeal docketed, No. 82-1074 (10th Cir. Jan. 15, 1982). Because of the similarity in authority to manage the respective leasing programs, it would follow that the Secretary enjoys the same discretion to determine value of production with respect to offshore mineral leasing.

the highest price paid for a part or for a majority of production of like quality in the same field or area, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price paid or offered at the time of production in a fair and open market for the major portion of like-quality products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

(30 CFR 250.64 (1977)). It was amended in 1979 to provide:

The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be determined by the Director. In establishing the value, the Director shall consider: (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances or less than the value computed on the reasonable unit value established by the Secretary.

(30 CFR 250.64 (1982)). See 44 FR 61886, 61903 (Oct. 26, 1979). This amendment became effective December 1, 1979, only 19 days before the period in question ended. Under both versions of 30 CFR 250.64, the value for the produced gas is established after consideration of the listed factors, and both provide that the values shall never be less than the proceeds received by the lessee from the sale or disposal of the produced substances or less than the reasonable unit value established.

As noted, the value determination was presented to Amoco, unopposed, in February 1977. ^{8/} Any decision by MMS, or Survey, issued under the regulations concerning Outer Continental Shelf leasing must be appealed to the Director of that agency (MMS or Survey) within 30 days from service of the decision. 30 CFR 250.81; 30 CFR 290.3. The timeliness of Amoco's subsequent attack upon that determination was addressed in the decision appealed. Amoco concedes that it did not appeal the February 1, 1977, determination and waives contesting any royalty disagreement for the period prior to June 1, 1978. It asserts a right to appeal the royalty payments subsequent to "Notice to

^{8/} The lease provides that "[e]ach [value] determination [by the Secretary] shall be made only after due notice to the lessee and a reasonable opportunity has been afforded the lessee to be heard." Amoco presented a request for a royalty payment procedure in its Jan. 14, 1977, letter, but did not respond to the subsequent determination.

Lessees 78-2" (NTL) issued by Survey on June 1, 1978, and NGPA, arguing that both superseded the February 1977 determination and restricted the value for royalty computations on gas produced from OCS-G 2866 and received by FP&L to the proceeds obtained under the FP&L contract.

Amoco refers to section II of the NTL which provides that the royalty value for sales not subject to the price jurisdiction of the Federal Energy Regulatory Commission (FERC) and subject to an arm's-length contract "shall be established as the higher of: a. The price received by the lessee or operator in accordance with the provisions of the applicable sales contract, or, b. A minimum value of not less than 18.36 cents per mcf." ^{9/}

Pursuant to NGPA, effective December 1, 1978, the sale of all natural gas produced in the United States became subject to ceiling price limitations. Amoco argues that under the Act the contract price with FP&L is the maximum lawful price because the gas produced qualifies for sale only under section 105 of NGPA, 15 U.S.C. § 3315 (Supp. V 1981). This section provides that the maximum lawful price for sales of natural gas under any existing contract to which the gas is subject which was not committed to interstate commerce in November 1978 shall be the lower of either the price under the terms of the contract or else the price established for "new" uncommitted gas.

Amoco devotes a major portion of its statement of reasons alleging error in the value determination because Survey did not apply all the factors in 30 CFR 250.64. It asserts that Survey failed to explain why the royalty valuation was based upon the highest prices available in the market and argues that "like-quality" in this situation means gas to be produced which is committed for sale under a long-term obligation at a price reflecting the 1965 market. Indeed, we have held that there must be a reasonable basis for the determination to set value other than at the actual price received. Supron Energy Corp., 46 IBLA 181 (1980), appeal pending, Supron Energy Corp. v. Watt, Civ. No. 80-0463 (D.N.M. filed June 18, 1980). However, proceeds and fair market value may not be interchangeable when determining value of production. Wheless Drilling Co., 13 IBLA 21, 80 I.D. 599 (1973).

Amoco argues that the Director's decision is inconsistent with precedent. It specifically refers to a Federal Register notice, 47 FR 16423, 16425 (Apr. 16, 1982), which it claims proposed royalty valuation methods for Gulf of Mexico gas. However, the "preliminary finding" appearing in the notice of hearing is not relevant to the present circumstances inasmuch as it was not presented until well after the period in question and, moreover, the scheme presented does not appear inconsistent with that used by Survey in its value determination.

Amoco also cites two Fifth Circuit decisions, Bowers v. Phillips Petroleum, 692 F.2d 1015 (5th Cir. 1982), and Flowers v. Diamond Shamrock Corp.,

^{9/} MMS, in opposition, argues that the "NTL does not even purport to supersede the effectiveness of the underlying regulations upon which the specific royalty valuation at issue here was based."

693 F.2d 1146 (5th Cir. 1982). In holding that the value for royalty computation could not exceed the Federally regulated maximum price, each of those decisions involved gas produced under private lease agreements and subject to a sales contract.

After all of Amoco's arguments are considered, the narrow issue on appeal regarding the value determination is whether the gas produced from OCS-G 2866 and delivered to FP&L was subject to sale under the contract with FP&L. The valuation scheme which Amoco advocates is applicable to the gas delivered to FP&L depends upon the gas being "subject to" an existing contract.

The term "subject to," used in its ordinary sense, means "subordinate to" or "controlled by." See Black's Law Dictionary 1278 (5th ed. 1979). Under a "conventional sales" contract for the sale and delivery of natural gas, a producer promises to sell all the gas produced from either specific wells or specific fields. In other words, the production from a specific source is "dedicated" to the fulfillment of the contract. In a "warranty" contract, the producer agrees to sell a specific amount of gas and the gas delivered in satisfaction of this obligation may come from any source without regard to designated wells or fields. Shell Oil Co. v. Federal Power Commission, 531 F.2d 1324, 1327 n.6 (5th Cir. 1976).

The contract with FP&L does not specify a particular source, viz.: "Sellers own or control oil, gas and mineral leaseholds and/or lands in Southern Louisiana and offshore thereof, and Sellers will have a supply of gas available from their respective properties." In fulfilling the obligation to deliver, "[Sellers] may offer [gas] belonging to others." FP&L agrees "to purchase and receive, or pay for if available and not taken, from Sellers, collectively, the applicable Contract Demand Quantity per day, averaged over each month," which quantity was originally set as 100,000 MMBTU 10/ until December 31, 1967, and 200,000 MMBTU thereafter until the first occurrence of either the delivery of 1,424,500,000 MMBTU or the twentieth anniversary of the first delivery under the contract. Amoco continually argues that it was obligated by the contract to sell only gas produced from OCS-G 2866 or other sources in the area. The contract provisions do not support such conclusion. Furthermore, Amoco's statement that the contract is no longer a "warranty contract" is irrelevant to the period in question. The agreement was not converted to a "conventional sales contract" until June 9, 1982. 11/ Prior to that time Amoco had simply chosen to satisfy its contractual obligations to FP&L by delivering gas from OCS-G 2866. That business election cannot bind the United States to accept a lower royalty than it otherwise would be entitled had Amoco chosen some other source of supply for FP&L.

10/ MMBTU represents the quantity of natural gas which contains the equivalent of 1,000,000 British thermal units (total heating value).

11/ The Aug. 4, 1967, agreement which reinstated the FP&L contract provided that after the expiration of 15 years following the date of initial deliveries of gas, the sellers were obligated thereafter to deliver all gas produced from wells which were being used at that time to supply the gas delivered to FP&L under the contract. We do not address the efficacy or effect of that provision.

With regard to Amoco's assertion that it was locked into the price it received from FP&L, we note the Fifth Circuit decision in Shell Oil Co. v. Federal Power Commission, *supra*. The decision there was based on the determination that a contract to deliver a specified amount of gas at a specified price, or a warranty contract, did not preclude the seller from seeking approval from FPC of higher prices for gas from sources previously used to supply the buyer under the warranty. Likewise, Amoco was not prevented from selling at a higher price the gas produced from OCS-G 2866.

MMS' declaration of underpaid royalties does not create unjust enrichment. Under the circumstances, Amoco's obligation to pay royalties at prevailing "highest price" or "fair market value" is not lessened because it has made long term warranty commitments. The regulations clearly allow the super-imposition of a value determination based on actual market conditions on any sales price which falls below the standard of reasonableness. The United States is entitled to its royalty based on "the reasonable value" of the gas as set by the Secretary, which may not be less than the highest price received for similar gas.

Where a party challenges a determination as to the value of gas or other hydrocarbons produced from a lease with the United States, the party must establish that the methodology used is, in fact, erroneous. Supron Energy Corp., 55 IBLA 318, 322 (1981), *appeal pending*, Atlantic Richfield v. Watt, Civ. No. 81-0615 (D.N.M. *filed* July 29, 1981). Survey's February 1, 1977, value determination letter established the category of gas sold to FP&L and the July 20, 1982, determination provided Amoco with the corrected computations of the royalties owed. Amoco has failed to demonstrate error in the Director's decision upholding the value determination and royalty recomputation.

[2] In regard to the late payment assessment, Amoco claims that such charge is premature because the matter was pending and its liability was unsettled. 30 CFR 250.49 authorizes MMS to impose a late payment interest charge where payments are untimely or improper, including underpayments. *See Atlantic Richfield Co.*, 21 IBLA 98, 82 I.D. 316 (1975). The charges under 30 CFR 250.49 are assessed from the date on which the payment was due until the date on which it was received.

Amoco claims that Survey was informed of its payment method in July 1979 and delayed in correcting the situation. It argues that the subsequent requirement to pay interest violates the "most fundamental notions of equity" in the face of such delay.

A discussion of equity necessarily includes a review of the underlying circumstances. Amoco was informed of the royalty payment procedures and the attendant value computation scheme for the sale of gas from OCS-G 2866 to FP&L. It could have promptly paid the monies due, accompanied by a protest, but apparently chose not to do so. Thus, it appears that it decided to use the funds rather than pay them to the United States, based on a hope that its interpretation of 30 CFR 250.64 would prevail. It is equitable that the United States should be compensated for the loss of the use of the funds due it under an express royalty computation and payment program.

As to Amoco's assertion that the Government is precluded from collection of the interest charge because of a failure to act, it is well established that the authority of the United States to enforce a public right or to protect a public interest is not vitiated or lost by acquiescence of its officers or by their laches, neglect of duty, failure to act, or delays in the performance of their duties. Alyson A. Allison, 72 IBLA 333 (1983); Warren L. Jacobs, 71 IBLA 385 (1983). This recognizes the realities of administering the collection of royalties. When the lessee's reports and payments are received, MMS cannot immediately know the correctness of such material. It must necessarily take time to assemble the necessary data and then interpret it. Delays are reasonable in view of the burden upon it to perform this audit function for the many leases it must manage. Postpayment audits are a common incident to mineral lease management. See e.g., Mobil Oil Corp., 65 IBLA 295 (1982). Contrary to Amoco's claim, the delay in its payment of the correct amount due is attributable to its own activities and not those of MMS.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Edward W. Stuebing
Administrative Judge

We concur:

C. Randall Grant, Jr.
Administrative Judge

Douglas E. Henriques
Administrative Judge

